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United States General Accounting Office  
Washington, DC 20548

Office of Special Investigations

B-285977

August 24, 2000

The Honorable Richard Durbin  
The Honorable Tom Harkin  
United States Senate

The Honorable Peter DeFazio  
The Honorable Carolyn B. Maloney  
House of Representatives

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Subject: Defense Inventory: Status of Navy Initiatives to Improve Its In-Transit Inventory Process

In response to your May 18, 2000, request, we are providing a status report on the Navy's initiatives to address, at least in part, a number of in-transit inventory problems that we identified in recent reports.<sup>1</sup> The information in this letter is based on what the Navy has reported to us as the specific actions it has taken to address the recommendations that we made in our March 1999 report. Concerns about the vulnerability of inventory shipments to fraud, waste, and abuse led the Congress to enact section 349 of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 (P.L. 105-261), which requires the Department of Defense to develop a comprehensive plan for tracking inventory while it is being shipped. We are currently reviewing the Department of Defense's implementation of its department-wide plan to address in-transit inventory management problems and will be reporting on our findings this fall.

### Results In Brief

In response to our recommendations, the Navy has reported a number of actions that, as specified below, are complete or in process. Overall, we are encouraged by the set of actions and believe that once they are fully implemented, short and long-term improvements in inventory management will result. We are particularly encouraged by the Navy's plan to reengineer its processes to create long-term system solutions.

<sup>1</sup>Department of the Navy: Breakdown of In-Transit Inventory Process Leaves It Vulnerable to Fraud (GAO/OSI/NSIAD-00-61, Feb. 2, 2000) and Defense Inventory: Navy's Procedures for Controlling In-Transit Items Are Not Being Followed (GAO/NSIAD-99-61, Mar. 31, 1999).

## **Recommendations and Reported Actions**

### Recommendation 1

The Navy should comply with existing Department of Defense and Navy procedures regarding material receipt acknowledgment of in-transit shipments and reemphasize follow-up procedures on unconfirmed warehouse and purchased material.

According to Department of Defense comments on our report, the Commander, Naval Supply Systems Command, has communicated the importance of the proper and timely posting of receipts and the prompt and accurate response to follow-up requests. Additionally, the Commander has chartered an Integrated Process Team to look at current systems, policies, and processes to investigate material receipt acknowledgement problems and proposed short-term solutions. Department of Defense officials also stated that the long-term solution to noncompliance with receipt and follow-up procedure would be to reengineer the entire in-transit process to include automation, elimination of errors, metrics to monitor the process, and incorporation of best business practices.

### Recommendation 2

The Navy should modify its integrated accounting and logistics systems so that they routinely update both financial and inventory records when in-transit inventory items are received. Until the systems are operational, the Naval Inventory Control Point in Philadelphia, Pennsylvania, should establish routine reconciliation procedures for their supply and financial records to ensure oversight and control over in-transit inventory items.

The Supply Systems Command's Integrated Process Team has designed an initiative known as "Brute Force" to provide temporary improvements in the manual reconciliation process until automated programming changes can be made. Brute Force involves the reallocation and increase in staff to (1) resolve unconfirmed receipts of warehoused material earlier, thereby avoiding potential write-offs; (2) reconcile in-transit write-offs of classified items with inventory records; and (3) perform causative research and analysis of write-offs of warehoused material.

The Brute Force team reportedly tracks and investigates unconfirmed receipts of warehoused material shipments valued at over \$300,000 and unconfirmed receipts of warehoused material shipments containing classified items. To date in fiscal year 2000, the Brute Force team reports successfully resolving 1,328 unconfirmed receipts of warehoused material at a reported valued at \$547.2 million, thus avoiding their write-off.

The Brute Force team also performed research and analysis to determine the cause of fiscal year 1999 warehoused material written off as lost at the Naval Inventory Control Point in Philadelphia. Based on its research and analysis, the team reported confirming that the Navy had written off as lost 8,542 shipments of warehoused material (valued at \$143.3 million) that had actually been received by the intended recipients. These discrepancies reduced the reliability of inventory reports, obscured true inventory losses, and misstated the number of items on hand. As of August 2000, Brute Force team personnel had corrected \$82.5 million of the \$143.3 million in write-off errors by reversing the write-offs and properly entering receipts for the shipments into Navy records.

Using data compiled from its results, the Brute Force team compiled summary data on inventory shipment losses that highlighted breakdowns in the physical distribution process and provided the team a means of assessing the effectiveness of the Navy's policies and procedures governing shipped inventory. For example, the compilation of such data facilitated the Supply Systems Command's ability to identify the predominant causes of shipped inventory losses, such as internal, customer procedure, and receipt-reporting process problems.

### Recommendation 3

The Navy should specifically target in-transit inventory problems as an issue for review in Federal Managers' Financial Integrity Act assessments.

According to the Navy's Office of Financial Operations, the Naval Inventory Control Point reviewed selected aspects of shipped inventory during its fiscal year 1999 management control review pursuant to the Federal Managers' Financial Integrity Act of 1982. In a September 1, 1999, letter to the Chief of Naval Operations, the Vice Commander, Naval Supply Systems Command, identified material weaknesses in Naval Inventory Control Point internal controls over shipped inventory. The Vice Commander's letter also outlined planned corrective actions, including milestones and timetables for completion. The corrective actions include (1) the identification and implementation of metrics to improve monitoring and performance measurement of the in-transit process, (2) automated program changes to improve visibility of sensitive items, (3) proof of shipment and delivery confirmation, and (4) evaluation of commercial practices and the in-transit processes of other military services. The corrective actions have an estimated completion date of December 2000.

### Recommendation 4

The Navy should establish performance measures, milestones, and timetables to help monitor the progress being made to reduce the vulnerability of in-transit inventory to undetected loss or misplacement.

The Naval Supply Systems Command established four goals at the Naval Inventory Control Point to reduce fiscal year 2000 write-offs and gain better control of classified, sensitive, and high-dollar value warehoused material. The goals, based on the number, value, and types of unconfirmed receipts of warehoused material shipments follow:

- Eighty percent of all unconfirmed receipts of warehoused material shipments (valued at over \$350,000) should be resolved within 180 days from the date the material was issued.
- All unconfirmed receipts of sensitive warehoused material shipments should be resolved within 180 days from the date the material was issued.
- All unconfirmed receipts of classified warehoused material shipments should be resolved within 120 days from the date the material was issued.
- The value of fiscal year 2000 warehoused material write-offs should be 30 percent less than the value of fiscal year 1999 warehoused material write-offs.

Progress toward attaining these goals is assessed monthly by the Commander, Naval Supply Systems Command.

The Naval Supply Systems Command also added in-transit metrics to its Corporate Information System as part of its efforts to reengineer the Navy's in-transit process. According to Navy officials, the Corporate Information System is available on the Web and provides users with data analysis tools, enabling them to quickly identify problem areas or activities so that focused corrective actions can be taken. The metrics in place provide various levels of aggregation dependent on user menu selection. Two metrics available in the Corporate Information System, along with additional aggregations specific to each metric, include

- dollar value and number of unconfirmed receipts of warehoused material, with additional aggregations involving separate receipt and issue transactions and the capability to sort by the activity that reports the issue or receipt and
- dollar value and number of inventory adjustments (e.g., incoming shipment and warehoused material write-offs), with additional aggregations involving the capability to sort by budget project and by the activity that processes the inventory adjustment.

Metrics have also been implemented to measure the follow-up process for aged transactions (i.e., backlogs of warehoused material discrepancy reports at each activity). The user can sort the data by budget project (e.g., Navy Working Capital Fund), receipt or issue transaction, action holder, and material classification. The information can be further stratified by overall document age, dollar value, and

response code. The response code provides the user with the cause of the unconfirmed warehoused-material receipt, which is extremely valuable in analyzing the in-transit process and identifying systemic problems.

According to Supply Systems Command officials, the Integrated Process Team briefs the Commander, Vice Commander, and Executive Director of the Naval Supply Systems Command about the metrics on a monthly basis. These briefings address timely issues using the implemented metrics, and the metrics are continuously reviewed and revised as necessary to ensure that the proper management attention is being paid to the in-transit process.

### **Agency Comments**

Senior-level logistics and supply officials of the Naval Supply Systems Command provided comments on a draft of this letter. The officials agreed with the facts presented and provided some clarifications. We revised our letter as appropriate.

### **Scope and Methodology**

To determine the Navy's progress in addressing our March 1999 recommendations, we held discussions with Naval Supply Systems Command officials in Mechanicsburg, Pennsylvania. To determine whether the Navy had emphasized in-transit inventory as part of its assessment of internal controls, we reviewed assessments from the Naval Supply Systems Command for fiscal year 1999.

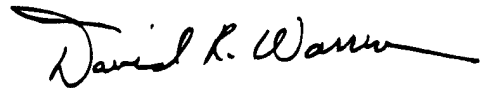
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We are sending copies of this letter to the appropriate congressional committees; the Honorable William S. Cohen, Secretary of Defense; the Honorable Richard Danzig, Secretary of the Navy; and the Honorable Jacob J. Lew, Director, Office of Management and Budget. Copies of this letter will also be made available to others upon request. If you have any questions regarding this letter, please call Robert Hast at (202) 512-6722 or David Warren at (202) 512-8412. Key contributors to this letter include John Ryan, Norman M. Burrell, Lawton Gist, and Sandra F. Bell.



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